Supreme Court, U.S.
FILED
06-467 SEP 29 2006
OFFICE OF THE CLERK

No. _____

In the Supreme Court of the United States

AMY LIU, et al.,

Petitioners,

v.

CREDIT SUISSE FIRST BOSTON CORP., INC., et al.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Whether Fed. R. Civ. P. 9(b) or Fed. R. Civ. P. 8(a) applies to the sufficiency of a pleading for the element of loss causation in a civil cause of action brought under §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, in light of this Court's recent decision in *Dura Pharms, Inc. v. Broudo*, 544 U.S. 336, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005), which decided upon a Circuit split as to the minimum pleading requirements for loss causation but also employed Fed. R. Civ. P. 8(a) in weighing the sufficiency of loss causation pleadings.

PARTIES TO THE PROCEEDING

The Petitioners include the following individuals:

Robert W. Tenney, Amy Liu, Robert Tate, Mary Gorton, Carla Kelly, Henry Ciesielski, Ed Grier, Frank Turk, Jennie Papuzza, Stanley Warren, Ellen Dulberger, Craig Mason, Sharon Brewer, and Antoine Kasprzak.

The Respondents are as follows:

Credit Suisse First Boston Corp., Inc., Credit Suisse First Boston (USA), Inc., Credit Suisse First Boston, Credit Suisse Group, Efficient Networks, Inc., eMachines, Inc., Lightspan Partnership, Inc., Tanning Technology Corp., and Tumbleweed Communications Corp.

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OPINIONS BELOW

The Second Circuit Court of Appeals Order Denying Rehearing on July 10, 2006 is unreported. App. A at 1a-2a. The Second Circuit Court of Appeals Opinion, issued on May 19, 2006 is unreported. App. B at 3a-6a. The Decision and Order of the United States District Court for the Southern District of New York, issued on June 28, 2005 is reported at 399 F.Supp.2d 298 (S.D.N.Y. 2005). App. C at 7a-31a.

JURISDICTION

The Second Circuit Court of Appeals affirmed the judgment of the District Court on May 19, 2006.

A petition for rehearing *en banc* was timely filed and the Petition was denied on July 10, 2006.

This petition is timely under 28 U.S.C. Section 2101 and Supreme Court Rule 13(1) because it is being filed within 90 days of the entry of the order denying rehearing *en banc* sought to be reviewed. This Court has jurisdiction to review the order of the United States Court of Appeals for the Second Circuit pursuant to 28 U.S.C. Section 1254.

RELEVANT FEDERAL RULES OF CIVIL PROCEDURE

Fed. R. Civ. P. 8 states as follows:

> (a) Claims for Relief. A pleading which sets forth a claim for relief, whether an original claim, counterclaim, cross-claim, or third-party claim, shall contain (1) a short and plain statement of the grounds upon which the court's jurisdiction depends, unless the

> court already has jurisdiction and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief the pleader seeks. Relief in the alternative or of several different types may be demanded.

Fed. R. Civ. P. 9(b) states as follows:

> (b) Fraud, Mistake, Condition of the Mind. In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

STATEMENT OF THE CASE

The jurisdiction of the District Court was invoked under 28 U.S.C. Section 1331 (general federal question jurisdiction). The federal claims are based upon allegations of the respondents violating § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated there under. Plaintiffs' case was dismissed pursuant to Fed. R. Civ. P. 12(b)(6). The District Court's sole finding on dismissal was that Plaintiffs' complaint failed to sufficiently plead the element of loss causation in the securities fraud cause of action under that Circuit's precedents.

Plaintiffs' case was initially filed on February 28, 2003 in the Southern District of Florida. Over Plaintiffs' objections, the Judicial Panel on Multi District Litigation transferred Plaintiffs' case to the Southern District of New York on

August 12, 2003 to be coordinated before the District Court there with the enormous consolidated action *In re: Initial Public Offering Securities Litigation ("In re IPO")* 241 F.Supp. 2d 281 (S.D.N.Y. 2003). In the "Transfer Order," the Panel stated that "Centralization under [28 U.S.C.] Section 1407 is necessary in order to ...*prevent inconsistent pretrial rulings*..." 277 F.Supp. 2d 1375, 1377 (Jud.Pan.Mult.Lit.,2003) (emphasis added). Prior to the transfer of Plaintiffs' case, the *In re IPO* District Court had already ruled on February 19, 2003 on the legal pleading requirements for all cases in the coordinated action, including the pleading requirement for the element of loss causation. "In this litigation, Plaintiffs have pled two securities fraud claims: one for market manipulation and another for material misstatements and omission in the registration statement. ... ***In both cases, Rule 9(b) governs the pleading of the remaining elements of the claims: loss causation***, transaction causation, reliance and damages." *In re IPO*, 241 F.Supp.2d 281, 335-336 (emphasis added). Plaintiffs' case was subjected to this District Court's ruling regarding the applicable pleading standards to be imposed by consequence of the transfer and coordination.

On April 1, 2005 the District Court issued its first opinion on Defendants' Fed. R. Civ. P. 12(b)(6) motions to dismiss Plaintiffs' complaint and stated as follows: "The United States Supreme Court is now considering what pleading standard should be applied to allegations of loss causation. [FN67"] *In re IPO*, 383 F.Supp. 2d 566, 578 (S.D.N.Y. 2005)(in footnote 67 referencing "*Dura Pharms., Inc. v. Broudo*, No. 03-932., cert. granted by *Dura Pharms.*, 124 S.Ct. 2904 (2004), argued Jan. 12, 2005"). Further, the District Court stated therein the following: "In any case, **any ruling** by the Supreme Court in *Dura Pharms.* will **certainly affect** the

pleading standard for misrepresentation cases like this one." 383 F.Supp.2d at 578, n.67(emphasis added).

Subsequent to the April 1, 2005 decision, Plaintiffs timely moved on April 15, 2005 for reconsideration under Fed. R. Civ. P. 59, which resulted in a new order dated May 16, 2005 and which granted Plaintiffs' motion in part but still dismissed Plaintiffs' case on the sole basis of the District Court's alleged finding that Plaintiffs' complaint failed to sufficiently plead the element of loss causation.

On April 19, 2005, between Plaintiffs' April 15, 2005 filing of their first motion for reconsideration and the District Court's subsequent May 16, 2005 decision on that motion, this Court ruled in *Dura Pharms, Inc. v. Broudo,* 544 U.S. 336 (2005), specifically on the issue of the pleading requirements for the element of loss causation in securities fraud cases. Consequently, on May 26, 2005 Plaintiffs timely filed a second motion for reconsideration under Fed. R. Civ. P. 59, and raised therein, in part, this Court's April 19, 2005 *Dura Pharms, Inc.* decision and its language which made clear that the burden on Plaintiffs in pleading the element of loss causation in a securities fraud cause of action is not supposed to be great. Further, Plaintiffs quoted therein clear language from *Dura Pharms, Inc.* in which this Court explicitly employed Fed. R. Civ. P. 8(a)(2)-- and not Fed. R. Civ. P. 9(b)-- in weighing the sufficiency of the pleading of the element of loss causation.

On June 28, 2005 the District Court denied Plaintiffs' May 26, 2005 second motion for reconsideration entirely and dismissed Plaintiffs' complaint with prejudice -- again solely on a finding that Plaintiffs' complaint failed to plead the element of loss causation sufficiently under the precedent law of that Circuit. In this decision, the District Court remarked

upon the recent *Dura Pharms, Inc.* decision but concluded "... *Dura* did not disturb Second Circuit precedent regarding loss causation." 399 F.Supp.2d 298, 301.

Plaintiffs timely filed an appeal from the District Court's dismissal and raised at length therein the impropriety of any heightened pleading standard beyond Fed. R. Civ. P. 8 for pleading loss causation. On the appeal, a three-judge panel of the Second Circuit Court of Appeals affirmed the District Court in a Summary Order. The Order stated "we affirm, substantially for the same reasons set out by the district court in its detailed final opinion dismissing the complaint." May 19, 2006 Order at 3, *Tenney v. Credit Suisse First Boston Corp., Inc.*, 2006 WL 1423785 (2d Cir. 2006).

Plaintiffs sought a rehearing *en banc* from the Circuit court and timely moved for such. The petition was denied by written order dated July 10, 2006. This Petition for a Writ of Certiorari to this Court has been filed within 90 days of the July 10, 2006, denial of the rehearing *en banc* petition to the Circuit Court.

REASONS FOR GRANTING THE PETITION

This case presents an important issue of federal law on which the Second Circuit's precedent conflicts with this Court's rulings. The Second Circuit's ruling upholds a Fed. R. Civ. P. 9(b) heightened pleading requirement for pleading the element of loss causation in a civil securities fraud action, contrary to this Court's recent opinion in *Dura Pharms, Inc.*, which clearly employed Fed. R. Civ. P. 8(a) as the applicable standard. It also conflicts with the clear directives given to the Second Circuit and other lower courts by this Court in the line of cases directing them to uphold the plain language of Fed. R. Civ. P. 8 rather than imposing stricter pleading

requirements, such as Fed. R. Civ. P. 9(b), unless specifically indicated otherwise by the Federal Rules-- even for those types of civil actions which may have become disfavored. *See Swierkiewicz v. Sorema*, 534 U.S. 506, 122 S.Ct. 992, 152 L.Ed.2d 1 (2002) (overruling the Second Circuit's precedent requiring a heightened pleading standard beyond Fed. R. Civ. P. 8 for employment discrimination cases, and finding its heightened pleading requirement directly in conflict with Fed. R. Civ. P. 8(a)'s express language); *Leatherman v. Tarrant County Narcotics Intelligence and Coordination Unit*, 507 U.S. 163, 113 S.Ct. 1160, 122 L.Ed.2d 517 (1993) (overruling the Fifth Circuit's "heightened pleading standard" requirement akin to Fed. R. Civ. P. 9(b) in alleging municipal liability under 42 U.S.C. § 1983, and finding its heightened pleading standard directly in conflict with Fed. R. Civ. P. 8(a)'s express language); *Conley v. Gibson*, 355 U.S. 41, 47, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957)(explaining that Fed. R. Civ. P. 8 means what is says and facts do not need to be pled). Consequently, the ruling at issue threatens to undermine the clear dictates of this Court and the Federal Rules of Civil Procedure in these cases of national importance – national securities cases, particularly those filed in the Second Circuit which contains the financial heart of the country.

The District Court explicitly stated that Fed. R. Civ. P. 9(b) applied to pleading the element of loss causation for the securities fraud cases coordinated before it under the *In re IPO* multi-district coordination, which ultimately included Plaintiffs' instant case. Further, the District Court's final opinion of June 28, 2005, adopted by the Court of Appeals, was clear that it was burdening Plaintiffs' complaint with a pleading requirement beyond Fed. R. Civ. P. 8 under the Second Circuit's precedents-- "[this Circuit's precedent] imposes a heavy burden on plaintiffs to plead [loss

causation]." 399 F.Supp. 2d at 309. Subsequently, in affirming the District Court's application of Fed. R. Civ. P. 9(b) and the heightened pleading requirement for loss causation, the Second Circuit Court of Appeals even stated that "the complaint's theory of loss causation ...ultimately fail[ed] to satisfy the strict pleading requirements set forth in [this Circuit's precedent]..." 2006 WL 1423785 at *1(emphasis added).

By sharp contrast, however, this Court in *Dura Pharms, Inc.*, 125 S.Ct. 1627, employed an entirely different and more permissive pleading standard-- Fed. R. Civ. P. 8-- in reviewing the adequacy of loss causation pleadings:

> We concede that the Federal Rules of Civil Procedure require only "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. Rule Civ. Proc. 8(a)(2). And we assume, at least for argument's sake, that neither the Rules nor the securities statutes impose any special further requirement in respect to the pleading of proximate causation or economic loss. ... We concede that ordinary pleading rules are not meant to impose a great burden upon a plaintiff. *Swierkiewicz v. Sorema N. A.*, 534 U.S. 506, 513-515, 122 S.Ct. 992, 152 L.Ed.2d 1 (2002).

Dura Pharms, Inc., 125 S.Ct. at 1634.

In addition, and of important noteworthiness, in *Dura Pharms, Inc.* the defendants and their Amici argued to this Court that a pleading requirement greater than Fed. R. Civ. P. 8 was required for loss causation allegations, and one amicus brief (*Sec. Ind. Ass'n Br.* at 9-10, n.6) even argued that a complaint was required to include expert testimony

regarding loss causation.[1] However, at oral argument in *Dura Pharms, Inc.*, several Justices reacted to the defendants' arguments for a heightened pleading standard for loss causation above Fed. R. Civ. P. 8 with unambiguous skepticism.

> **JUSTICE O'CONNOR**: Well, doesn't the general rule 8 governing complaints -- isn't that adequate? You have to plead under that every element of an affirmative case.
>
> ...
>
> **JUSTICE O'CONNOR**: Why is the Government proposing that you have to follow rule 9 not 8 or some other requirement?
>
> ...
>
> **JUSTICE GINSBURG**: But, Mr. Hungar, if you look at the forms of what's proper pleading under the Federal rules on causation, the sample pleadings say, for example, for money lent, the defendant owes the plaintiff for money lent. Period. Or for goods sold and delivered. Nothing more. Just alleged causation. Defendant -- plaintiff alleges I lost X amount and it was caused by defendant. I thought you pointed to the 9(b) rule because fraud must be pleaded with particularity, but causation does not, not under the rules and not under the statute.

---

[1] *Dura Pharms, Inc.* briefs -- Petitioner's Briefs: 2004 WL 2075752, 2004 WL 2988614 (U.S.); Amici Curiae Briefs in Support of Petitioners: 2004 WL 2045248, 2004 WL 2075751, 2004 WL 2069560, 2004 WL 2092648, 2004 WL 2069562, 2004 WL 2069561, 2004 WL 2069564, 2004 WL 2069563.

MR. HUNGAR [attorney for the Government]: Well, as we said in our brief, we think 9(b) applies here. Obviously, this is a fraud case.

JUSTICE GINSBURG: But that -- that's to the -—to the allegation of fraud, but not causation.

MR. HUNGAR: Well, Congress has made very clear that loss causation is an element of the cause of action. The elements must be pled. In a fraud case, they must be pled with particularity, but even -- even in a -- in a common law --

JUSTICE GINSBURG: It says -- no. It said fraud must be pleaded with particularity, not all the elements of a fraud claim.

MR. HUNGAR: Well, with respect, Your Honor, we think circumstances -- it does not constitute fraud if there is no loss causation. At least it certainly doesn't constitute securities fraud under this statute, and if the complaint does not plead loss causation, it hasn't pled fraud. So we submit that --

JUSTICE STEVENS: Well, that's not correct I don't think. I think there could be a completely fraudulent statement but no -- no damages as a result of it. There would still be fraud.

MR. HUNGAR: Yes, but in a -- in a private action for securities fraud, loss causation is an element of the cause of action. It's not an element in every fraud case.

> **JUSTICE STEVENS**: It's not an element of the fraud. It' s an element of the cause -- cause of action.

Dura Pharms, Inc. Tr. at 19-21, found at http://www.supremecourtus.gov/oralarguments/argument transcripts/03-932.pdf (emphasis added).

CONCLUSION

The petition for a writ of certiorari should be granted so that this Honorable Court can consider the merits of the question for review.

Respectfully submitted,

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Dated: September 29, 2006

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Nos. 05-3430-cv, 05-4759-cv, 05-4760-cv

[Filed July 10, 2006]

ROBERT W. TENNEY, AMY LIU, M.D., ROBERT TATE, MARY GORTON, CARLA KELLY, HENRY CIESIELSKI, ED GRIER, FRANK TURK, JENNIE PAPUZZA, STANLEY WARREN, ELLEN DULBERGER, CRAIG MASON, SHARON BREWER, and ANTOINE KASPRZAK,
Plaintiffs-Appellants-Cross-Appellees,

v.

CREDIT SUISSE FIRST BOSTON CORP., INC., CREDIT SUISSE FIRST BOSTON (USA), INC., CREDIT SUISSE FIRST BOSTON, CREDIT SUISSE GROUP, EFFICIENT NETWORKS, INC., eMACHINES, INC., LIGHTSPAN PARTNERSHIP, INC., TANNING TECHNOLOGY CORP. and TUMBLEWEED COMMUNICATIONS CORP.,
Defendants-Appellees-Cross-Appellants,

ORDER

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the Plaintiff Appellants-Cross-Appellees Robert W. Tenney, et al. Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

For the Court,

Roseann B. Mackechnie, Clerk

By: /s/_____
Motion Staff Attorney

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Nos. 05-3430-cv, 05-4759-cv, 05-4760-cv

[Filed May 19, 2006]

ROBERT W. TENNEY, AMY LIU, M.D., ROBERT TATE, MARY GORTON, CARLA KELLY, HENRY CIESIELSKI, ED GRIER, FRANK TURK, JENNIE PAPUZZA, STANLEY WARREN, ELLEN DULBERGER, CRAIG MASON, SHARON BREWER, and ANTOINE KASPRZAK, Plaintiffs-Appellants-Cross-Appellees,	)
v.	)
CREDIT SUISSE FIRST BOSTON CORP., INC., CREDIT SUISSE FIRST BOSTON (USA), INC., CREDIT SUISSE FIRST BOSTON, CREDIT SUISSE GROUP, EFFICIENT NETWORKS, INC., eMACHINES, INC., LIGHTSPAN PARTNERSHIP, INC., TANNING TECHNOLOGY CORP. and TUMBLEWEED COMMUNICATIONS CORP., Defendants-Appellees-Cross-Appellants,	)

Appeal from the United States District Court
for the Southern District of New York (Scheindlin, J.)

Present: HON. THOMAS J. MESKILL, HON. CHESTER J. STRAUB, HON. ROBERT A. KATZMANN, Circuit Judges.

SUMMARY ORDER

ON CONSIDERATION WHEREOF, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of the district court is **AFFIRMED**.

The plaintiffs in this action brought a complaint under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, alleging that the six defendants-appellees – five issuers of securities that went public during the late 1990s (the "issuer defendants") and the investment bank that underwrote their initial public offerings (Credit Suisse First Boston and its related entities, collectively "CSFB") – had engaged in a complex scheme to defraud investors. Pursuant to that scheme, according to the plaintiffs, the issuer defendants and CSFB deliberately understated their earnings estimates while simultaneously reminding investors of the potential for "upside surprises," thereby creating "excitement in the marketplace when the stocks at issue beat estimate after estimate, conditioning the market to expect superior performance from those stocks and artificially inflating their prices." *See In Re Initial Pub. Offering Sec. Litig.*, 383 F. Supp. 2d 566, 570 (S.D.N.Y. 2005). The plaintiffs allege that they relied on this illusion when purchasing stock in the various issuer defendants, and that when this cycle eventually ended, they suffered a loss.

The district court – first in its initial opinion on the defendants' motion to dismiss, *see id.*, and then in its two

opinions regarding the plaintiffs' motions for reconsideration, *see In Re Initial Pub. Offering Sec. Litig.*, 399 F. Supp. 2d 261 (S.D.N.Y. 2005); *Liu v. Credit Suisse First Boston Corp. (In re Initial Pub. Offering Secs. Litig.)*, 399 F. Supp. 2d 298 (S.D.N.Y. 2005) – repeatedly dismissed the complaint on grounds that it did not adequately plead loss causation. The plaintiffs now appeal that dismissal. Meanwhile, the defendants cross-appeal the district court's subsequent denial of their motion for sanctions. *See In Re Initial Pub. Offering Sec. Litig.*, 399 F. Supp. 2d 369 (S.D.N.Y. 2005).

With regard to the plaintiffs' appeal of the district court's dismissal of their complaint, we affirm, substantially for the same reasons set out by the district court in its detailed final opinion dismissing the complaint. *See In Re Initial Pub. Offering Sec. Litig.*, 399 F. Supp. 2d at 307-09.

With regard to the defendants' cross-appeal of the district court's decision not to award sanctions pursuant to Rule 11 of the Federal Rules of Civil Procedure and the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), we also affirm. We review a district court's decision to impose (or not impose) sanctions pursuant to Rule 11 of the Federal Rules of Civil Procedure and the PSLRA under an "abuse of discretion" standard. *See, e.g., Gurary v. Nu-Tech Bio-Med, Inc.*, 303 F.3d 212, 219 (2d Cir. 2002). Here, we conclude that the district court did not abuse its discretion in declining to award sanctions. The district court acted within its discretion in concluding that the complaint's theory of loss causation, while ultimately failing to satisfy the strict pleading requirements set forth in *Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161 (2d Cir. 2005), was not frivolous. *See In Re Initial Pub. Offering Sec. Litig.*, 399 F. Supp. 2d at 372. Similarly, it was within its discretion in concluding that sanctions were not warranted with respect to the plaintiffs'

claims against Tumbleweed Communications Corp., Tanning Technology Corp., and eMachines, Inc., given that under a broad reading of the amended complaint, there was a plaintiff with standing to sue each of these defendants. *See id.* at 373-75. The remaining arguments that the defendants-appellees now press in support of sanctions were either not raised to the district court at all, or were raised so briefly that the district court's lack of consideration of them cannot be considered an abuse of discretion.

Accordingly, the decisions of the district court to dismiss the plaintiffs' complaint and to deny the defendants' requests for sanctions are therefore **AFFIRMED**.

FOR THE COURT:
ROSEANN B. MacKECHNIE, CLERK
By:

_____

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 04 Civ. 03757 (SAS)

[Filed June 28, 2005]

IN RE: INITIAL PUBLIC OFFERING SECURITIES LITIGATION;

This document relates to:

AMY LIU, ROBERT TENNEY, ROBERT TATE, MARY GORTON, CARLA KELLY, HENRY CIESIELSKI, ED GRIER, FRANK TURK, JENNIE PAPUZZA, STANLEY WARREN, ELLEN DULBERGER, CRAIG MASON, AND SHARON BREWER,
Plaintiffs,
v.
CREDIT SUISSE FIRST BOSTON CORP., CREDIT SUISSE FIRST BOSTON (USA), INC., CREDIT SUISSE FIRST BOSTON, CREDIT SUISSE GROUP, EFFICIENT NETWORKS, INC., eMACHINES, INC., LIGHTSPAN PARTNERSHIP, INC., TANNING TECHNOLOGY CORP., AND TUMBLEWEED COMMUNICATIONS CORP.,
Defendants.

SHIRA A. SCHEINDLIN, U.S.D.J.:

OPINION AND ORDER

I. INTRODUCTION

In an Opinion and Order dated April 1, 2005, this Court dismissed plaintiffs' claims in this action, No. 04 Civ. 3757, in their entirety.[1] Plaintiffs moved for reconsideration. On May 13, 2005, I granted plaintiffs' motion in part, but reaffirmed the dismissal of plaintiffs' claims because plaintiffs had failed to plead loss causation.[2] Plaintiffs now move for reconsideration of the May 13 Opinion.[3]

II. LEGAL STANDARD

A motion for reconsideration is governed by Local Rule 6.3 and is appropriate where a court overlooks "controlling decisions or factual matters that were put before it on the

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[1] *See Liu v. Credit Suisse First Boston Corp. (In re Initial Pub. Offering Sec. Litig.)*, 383 F. Supp. 2d 566, 2005 U. S. Dist. LEXIS 5339, 2005 WL 743550 (S.D.N.Y. 2005) *("Liu II")*.

[2] *See In re IPO*, 399 F. Supp. 2d 261, 2005 U.S. Dist. LEXIS 9318, No. 21 MC 92, 2005 WL 1162445 (S.D.N.Y. May 13, 2005) *("Liu Reconsideration")*.

[3] *See* Plaintiffs' Memorandum in Support of the Rule 59(e) Motion to Alter, Amend, or Vacate the Order of May 13, 2005, Dismissing the Plaintiffs' Complaint ("2d Reconsideration Mem."). As they did in their first motion for reconsideration, plaintiffs have styled their motion under 59(e) rather than Local Rule 6.3. As I noted in my May 13 Opinion, there is no difference between the two. *See Liu Reconsideration*, 2005 U. S. Dist. LEXIS 9318, 2005 WL 1162445, at *1.

underlying motion . . . and which, had they been considered, might have reasonably altered the result before the court."[4] Alternatively, a motion for reconsideration may be granted to "correct a clear error or prevent manifest injustice."[5] Reconsideration is an "extraordinary remedy to be employed sparingly in the interests of finality and conservation of scarce judicial resources."[6]

Local Rule 6.3 should be "narrowly construed and strictly applied" to avoid repetitive arguments on issues that have been considered fully by the Court.[7] A motion for reconsideration "is not a substitute for appeal;"[8] nor is it "a 'second bite at the apple' for a party dissatisfied with a court's

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[4] *Range Road Music, Inc. v. Music Sales Corp.*, 90 F. Supp. 2d 390, 392 (S.D.N.Y. 2000) (quotation marks and citation omitted). *See also Shrader v. CSX Transp., Inc.*, 70 F.3d 255, 257 (2d Cir. 1995) ("The standard for granting . . . a motion [for reconsideration] is strict, and reconsideration will generally be denied unless the moving party can point to controlling decisions or data that the court overlooked — matters, in other words, that might reasonably be expected to alter the conclusion reached by the court.").

[5] *Doe v. New York City Dep't of Soc. Servs.*, 709 F.2d 782, 789 (2d Cir. 1983).

[6] *In re Health Mgmt. Sys., Inc. Sec. Litig.*, 113 F. Supp. 2d 613, 614 (S.D.N.Y. 2000).

[7] *Greenes v. Vijax Fuel Corp.*, 2004 U.S. Dist. LEXIS 12503, No. 02 Civ. 450, 2004 WL 1516804, at *1 (S.D.N.Y. July 7, 2004).

[8] *RMED Int'l, Inc. v. Sloan's Supermarkets, Inc.*, 207 F. Supp. 2d 292, 296 (S.D.N.Y. 2002) (quotation omitted).

ruling."[9] Courts have repeatedly been forced to warn counsel that such motions should not be made reflexively, "to reargue those issues already considered when a party does not like the way the original motion was resolved."[10] A motion under Local Rule 6.3 "shall be served within ten (10) days after the entry of the court's order determining the original motion."[11]

On April 19, 2005, in *Dura Pharmaceuticals, Inc. v. Broudo*,[12] the Supreme Court rejected the Ninth Circuit's permissive pleading standard for loss causation, which required only that a plaintiff allege that she had bought a security at an artificially inflated price.[13] The Court noted that "it should not prove burdensome for a plaintiff who has suffered an economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind. At the same time, allowing a plaintiff to forgo giving any indication of the economic loss and proximate cause that the plaintiff has in mind would bring about harm of the very sort the statutes seek to avoid."[14]

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[9] *Pannonia Farms, Inc. v. USA Cable*, 2004 U.S. Dist. LEXIS 15737, No. 03 Civ. 7841, 2004 WL 1794504, at *2 (S.D.N.Y. Aug. 10, 2004).

[10] *Houbigant, Inc. v. ACB Mercantile*, 914 F. Supp. 997, 1001 (S.D.N.Y. 1996).

[11] S.D.N.Y. Local Rule 6.3. *See also* Fed. R. Civ. P. 59(e) (same).

[12] 125 S. Ct. 1627, 1630, 161 L. Ed. 2d 577 (2005).

[13] *See Broudo v. Dura Pharms., Inc.*, 339 F.3d 933, 938 (9th Cir. 2003).

[14] *Dura*, 125 S.Ct. at 1634.

Dura did not establish what *would* be a sufficient loss causation pleading standard; it merely established what was *not*. However, *Dura* cited the stricter standards of the Second, Third, Seventh and Eleventh Circuits' standards as those with whom "the Ninth Circuit's views about loss causation differ."[15] The Court did not explicitly modify the stricter standards of those Circuits when it rejected the Ninth Circuit's lenient standard; accordingly, *Dura* did not disturb Second Circuit precedent regarding loss causation.

III. PLAINTIFFS' ARGUMENT

Plaintiffs' second motion for reconsideration focuses on the Court's May 13 decision that plaintiffs had not adequately pled loss causation.[16] Essentially, plaintiffs contend that the Court misconstrued the relevant legal standard for loss causation, as articulated in the Second Circuit's decision in *Lentell v. Merrill Lynch & Co., Inc.*[17] In the May 13 Order, I noted that:

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[15] *Id.* at 1630 (citing *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 198 (2d Cir. 2003)).

[16] Plaintiffs also quibble with the Court's description of the alleged scheme, devoting four pages to the proposition that "the artificial inflation occurred *before* the actual results were announced to have beaten the pre-existing estimates." 2d Reconsideration Mem. at 8. Because plaintiffs have not sufficiently alleged that the alleged scheme caused their losses, the exact timing of the alleged artificial inflation is irrelevant. Moreover, to the extent that plaintiffs now raise questions of transaction causation that were addressed in my April 1, 2005 Order, the ten-day deadline for reconsideration motions has expired. *See* S.D.N.Y. Local Rule 6.3; Fed. R. Civ. P. 59(e).

[17] 396 F.3d 161 (2d Cir. 2005).

> in material misstatement and omission cases, a court cannot presume dissipation of the inflationary effect; a plaintiff must explicitly allege a disclosure or some other corrective event. Moreover, to establish loss causation, a plaintiff must allege . . . that the *subject* of the fraudulent statement or omission was the cause of the actual loss suffered, *i.e.*, that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security.[18]

Plaintiffs contend that *Lentell* simply requires "that the Plaintiffs' Complaint alleges facts to support that the misstatements or omissions were the 'proximate cause' . . . of the investment loss."[19] Plaintiffs contend that, under *Lentell*, "'proximate cause' is construed broadly, except that it logically requires that the *subject* of the fraudulent statement or omission was the cause of the actual loss suffered."[20] Plaintiffs argue that the corrective disclosure requirement of *Lentell* was in fact just one of several possible ways for plaintiffs to allege loss causation, and that plaintiffs' failure to allege any corrective disclosures has no effect on any of the other methods by which plaintiffs may adequately plead loss causation.[21]

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[18] *Liu Reconsideration*, 2005 U.S. Dist. LEXIS 9318, 2005 WL 1162445, at *3 (footnotes and quotation marks omitted).

[19] 2d Reconsideration Mem. at 5.

[20] *Id.*

[21] *See id.* at 5-6 (summarizing plaintiffs' apprehension of the *Lentell* test as follows: "[1] was the subject of those 'misstatements and omissions' the cause of the decline in stock values that

Plaintiffs' confusion is understandable. As the Second Circuit noted in *Suez Equity Investors, L.P. v. Toronto-Dominion Bank,* the Circuit has produced "somewhat inconsistent precedents on loss causation."[22] Indeed, although the Circuit has issued several opinions dealing with loss causation in the last few years, the standard remains ambiguous.[23]

IV. DISCUSSION

A. Reconciling the Second Circuit's Loss Causation Standard

The Circuit's most recent decision on loss causation, *Lentell v. Merrill Lynch,* notes that "we follow the holdings of [three earlier Second Circuit cases,] *Emergent Capital,*

Plaintiffs claim as their loss? or [2] was there any corrective disclosure regarding the falsity of those 'misstatements and omissions' so as to cause [] the decline in stock values that Plaintiffs claim as their loss? [] or [3] have Plaintiffs alleged that the Defendants concealed or misstated any risks associated with an investment in those securities, some of which presumably caused Plaintiffs' losses?") (bracketed numbers in original).

[22] 250 F.3d 87, 98 n.1 (2d Cir. 2001).

[23] *See Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 187 ("While loss causation is easily defined, its application to particular facts has often been challenging."); *Emergent Capital,* 343 F.3d at 198 (including a section entitled "*Suez Equity* Clarified"); *Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 173 (2d Cir. 2005) ("acknowledging that [the] opinion in *Suez Equity* can be mis-read").

Castellano and *Suez Equity*."[24] Lentell's loss causation standard, though, is difficult to parse. To begin, *Lentell* holds that:

> Thus to establish loss causation, "a plaintiff must allege ... that the *subject* of the fraudulent statement or omission was the cause of the actual loss suffered," i.e., that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security. Otherwise, the loss in question was not foreseeable.[25]

But Lentell's full discussion of loss causation spans several pages, at times asserting different formulations of the loss causation standard. For example, the *Lentell* decision later posits that "this Court's cases — post-Suez and pre-Suez — require both that the loss be foreseeable *and* that the loss be caused by the materialization of the concealed risk."[26] On the next page of the decision, the court continues to reformulate its standard, noting that "our precedents make clear that loss causation has to do with the relationship between the plaintiff's investment loss and the information misstated or concealed by the defendant. If that relationship is sufficiently direct, loss causation is established . . . ."[27] Finally, *Lentell* also states the loss causation standard in the negative: "[i]t is not enough to allege that a defendant's misrepresentations and

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[24] *Lentell*, 396 F.3d at 174.

[25] *Id.* at 173 (quoting *Suez Equity*, 250 F.3d at 95) (emphasis in *Lentell*).

[26] *Lentell*, 396 F.3d at 173.

[27] *Id.* at 174 (citations omitted).

omissions induced a purchase-time value disparity between the price paid for a security and its true investment quality."[28]

Thus, over time, the Second Circuit has advanced several different standards for pleading loss causation, including "direct causation,"[29] "materialization of risk,"[30] and

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[28] *Id.* (quotation marks and citations omitted).

[29] *See id.* at 174 ("If that relationship [between 'the plaintiff's investment loss and the information misstated'] is sufficiently direct, loss causation is established . . . ."). *See also Suez Equity*, 250 F.3d at 98 n.1 (construing *First Nationwide Bank v. Gelt Funding Co.*, 27 F.3d 763, 769-70 (2d Cir. 1994) as "relying on 'direct causation' analysis for loss causation"). In *First Nationwide*, a RICO case involving allegations that lenders were fraudulently induced to make nonrecourse loans for the purchase of real estate, the Circuit dismissed a complaint for a number of reasons, including: (1) plaintiff had not adequately pled materiality; (2) intervening factors (including a market-wide downturn in real estate prices) likely caused plaintiff's losses; and (3) five years had elapsed between the alleged misrepresentations and the losses suffered. *See First Nationwide*, 27 F.3d at 772 (noting that "[h]ere, no social purpose would be served by encouraging everyone who suffers an investment loss because of an unanticipated change in market conditions to pick through loan applications with a fine-tooth comb in the hope of uncovering a misrepresentation.") (quotation marks, citation and alteration omitted).

[30] *See Lentell*, 396 F.3d at 173 (requiring "that the loss be caused by the materialization of the concealed risk"). *See also Suez Equity*, 250 F.3d at 98 n.1 (calling the Seventh Circuit's "materialization of risk" standard — which involves "inquiring whether the loss at issue was caused by the materialization of a risk that was not disclosed because of the defendant's fraud" — "both principled and predictable," but noting that the Second Circuit is "not writing on a blank slate, and believe[s] that the approach here

"corrective disclosure,"[31] all of which are referenced in *Lentell*. However, a close look at the recent discussion of loss causation by the Second Circuit reveals that the loss causation pleading standard, although murky, is not internally inconsistent.

Part of the problem lies in the continued expansion of the definition of "securities fraud." Some unlawful activities, such as "jaywalking," have clearly defined limits and comprise a limited range of human behavior. Securities fraud, by contrast, encompasses many distinct types of fraudulent activities, each of which causes harm in different ways. For example, a broker may "churn" a client's investments — *i.e.*, make excessive trades to generate broker commissions — and harm the client by generating large commissions.[32] A broker may assure a client that the broker will only make "safe" investments, and then spend the client's money on extremely risky securities, which lose value; in such cases, the client is harmed when the concealed risk — the volatility of the actual investments — lowers the value of her portfolio.[33] A manipulative potential partner may fraudulently persuade a sole proprietor to issue shares in a closely held company, and then dismantle the company or force out the original owner,

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articulated best reconciles our precedents to date.").

[31] *See Lentell*, 396 F.3d at 175 n.4 (finding that, because plaintiffs alleged no corrective disclosures, they could not establish loss causation).

[32] *See, e.g., Caiola v. Citibank, N.A.*, 295 F.3d 312 (2d Cir. 2002).

[33] *See, e.g., Louros v. Kreicas*, 367 F. Supp. 2d 572, 592-93 (S.D.N.Y. 2005).

causing the owner to lose money as the company's profits diminish.[34] A corporation with a right of first refusal on its preferred stock might assure a shareholder seeking to cash in his preferred shares that "nothing [seriously affecting share value] is going to change in the near future" when in fact the corporation knows that a recapitalization likely to enhance share prices is imminent; in such a case, the loss is caused when the employee misses out on a surge in stock prices after the recapitalization occurs.[35]

All of these examples of securities fraud cause a loss to the injured party. The mechanisms for such losses vary widely. However, the common thread is that, in each situation, "the loss be foreseeable and [] the loss be caused by the materialization of the concealed risk."[36] This is true even of the "somewhat inconsistent" precedents the Circuit attempted to reconcile in *Suez Equity,* which resulted in a legal standard that itself has required numerous clarifications.[37]

In *Suez Equity,* the Second Circuit offered the following as an explanation of its holding:

> The standard that we have employed in this opinion attempts to reconcile what we view as our somewhat inconsistent precedents on loss causation. *See, e.g., First Nationwide Bank v. Gelt Funding Co.,* 27 F.3d

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[34] *See, e.g., Weiss v. Wittcoff,* 966 F.2d 109 (2d Cir. 1992).

[35] *Castellano,* 257 F.3d at 175.

[36] *Lentell,* 396 F.3d at 173 (emphasis omitted).

[37] *Suez Equity,* 250 F.3d at 98 n.1.

> 763, 769-70 (2d Cir. 1994) (recognizing "foreseeability" approach, but relying on "direct causation" analysis for loss causation); *Weiss v. Wittcoff*, 966 F.2d 109, 111 (2d Cir. 1992) (per curiam) (following "foreseeability" approach); *Mfrs. Hanover Trust Co. v. Drysdale Secs. Corp.*, 801 F.2d 13, 22 (2d Cir. 1986) (finding loss causation where "investment quality" of securities was misrepresented). Were we unconstrained by our own precedents, we might propose a different standard. We note that the approach of the Seventh Circuit — inquiring whether the loss at issue was caused by the materialization of a risk that was not disclosed because of the defendant's fraud — appears to be both principled and predictable. *See Bastian v. Petren Res. Corp.*, 892 F.2d 680, 685-86 (7th Cir. 1990); *see also Caremark, Inc. v. Coram Healthcare Corp.*, 113 F.3d 645, 648 (7th Cir. 1997) ("To plead loss causation, the plaintiff must allege that it was the very facts about which the defendant lied which caused its injuries."). But, we are not writing on a blank slate, and believe that the approach here articulated best reconciles our precedents to date.[38]

Upon closer examination, however, the purportedly "inconsistent precedents" are more consistent than they might initially appear to be. That closer examination is warranted in light of the apparent confusion that reigns with respect to the element of loss causation. A chronological review may be the best approach to the required close examination.

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[38] *Id.* (quoting the entirety of footnote one of the *Suez Equity* opinion).

In 1986, the Circuit decided *Manufacturers Hanover Trust,* in which the court established the "investment quality" standard for material misrepresentation cases.[39] In that case, the court held that the defendant had misrepresented the risks associated with an investment in a company whose assets were extremely unstable. Eventually, the very instability that defendant had concealed caused the collapse of the company, resulting in the loss of the investment. Thus the misrepresentation went to the investment quality of plaintiff's investment, because plaintiff "would not have contracted with [defendant] . . . [to invest] had [plaintiff] known of the misrepresentation . . . particularly given that the [] statements were in part a response to the financial community's concern regarding [defendant's] stability."[40]

In 1992, the Circuit decided the *Weiss* case, in which defendants persuaded plaintiff to sell them half his company in return for defendants' promise to provide necessary supplies.[41] But defendants did not disclose that they had no

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[39] *Manufacturers Hanover Trust,* 801 F.2d at 22. *Manufacturers Hanover Trust* addressed the question of whether the district judge had properly instructed a jury, which ultimately returned an award of $ 17 million, as to the legal standard for *proving* — not *pleading* — loss causation. The Circuit found that the district court, in its charge on "proximate cause," had satisfactorily instructed the jury on loss causation. Despite the different procedural posture, *Suez Equity* relied on *Maufacturers Hanover Trust,* as well as *Weiss* and *First Nationwide Bank* (both pleading cases), in formulating its pleading standard for loss causation.

[40] *Id.*

[41] *See Weiss,* 966 F.2d at 110-11.

intention of keeping their promise but rather intended to take over plaintiff's business and force the plaintiff out. The court held that "it was quite foreseeable that the consummation of defendants' secret intention not to perform their promises would cause Weiss to suffer a loss."[42]

In both *Manufacturers Hanover Trust* and *Weiss*, the court held that loss causation could be pled by alleging that (1) defendants concealed a foreseeable risk associated with a securities transaction between plaintiffs and defendants; and (2) the foreseeable risk occurred causing plaintiffs' loss. The difference between the two cases is that one involved an *investor* (hence the phrase "investment quality"), and the other involved an *issuer of securities* (hence the term "foreseeability"). But both cases involved a concealment of negative information which caused the plaintiff's loss when the concealed information eventually caused the transaction to fail.

In 1994, the Circuit decided the third loss causation case cited in *Suez Equity*, which allegedly established a "direct causation" requirement.[43] But *First Nationwide Bank* did no such thing, for the following reasons. *First*, it was not a securities case at all, but a RICO case, involving allegations that a lender was fraudulently induced to make nonrecourse

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[42] *Id.* at 112.

[43] *See First Nationwide Bank*, 27 F.3d at 765-66. Indeed, it is unclear from the text of *First Nationwide Bank* and *Suez Equity* what a "direct causation" requirement might mean in the context of securities fraud, where statements made to no investor in particular, but disseminated to the public, have consistently been found to have caused investor losses when the statements concealed a risk and the risk materialized.

loans for purchases of real estate whose value was materially misstated. The case addressed "proximate cause" rather than "loss causation," which the *Lentell* court later described as an "imperfect" analogy.[44] *Second,* the court found that several factors prevented plaintiffs from pleading proximate cause: (1) plaintiff offered no valid methodology for calculating the magnitude of the misrepresentation regarding the value of the real estate; (2) five years had elapsed between the time of the misrepresentation and the time of the loss; and (3) a massive market-wide downturn in real estate prices had occurred during the interim.[45] Nonetheless, in articulating its standard,

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[44] *Lentell,* 396 F.3d at 173.

[45] *See First Nationwide Bank,* 27 F.3d at 770-72. Indeed, the Second Circuit decision on which *First Nationwide Bank* relies for support of its "direct causation" requirement — *Standardbred Owners Ass'n v. Roosevelt Raceway Assocs., L.P.,* 985 F.2d 102, 104 (2d Cir. 1993) — refers to the requirement that plaintiff's injuries be "directly *related*" to the alleged wrongdoing, not "directly *caused*" by it. *See Standardbred,* 985 F.2d at 104 ("These opinions emphasize the necessity of proof in a RICO case that the defendant's violations were a proximate cause of the plaintiff's injury, *i.e.,* that there was a *direct relationship* between the plaintiff's injury and the defendant's injurious conduct.") (emphasis added). The Supreme Court case on which both *Standardbred* and *First Nationwide Bank* further relied, *Holmes v. Securities Investor Protection Corp,* 503 U.S. 258, 117 L. Ed. 2d 532, 112 S. Ct. 1311 (1992), is a case about indirect injury in the context of the securities laws. *Holmes* involved a multi-tiered chain of injury in a securities fraud case, in which plaintiffs alleged that an individual's manipulation of securities caused securities prices to crash, thereby causing injury to two broker-dealers. Those broker-dealers, in turn, were subsequently unable to fulfill their own obligations to plaintiffs. *Holmes* is a classic proximate cause decision in which the chain of causation is too diffuse to fairly hold a defendant liable for

First Nationwide Bank offered the following summary of the law of proximate cause: "in addition to showing that but for the defendant's misrepresentations the transaction would not have come about, the [plaintiff] must show that *the misstatements were the reason the transaction turned out to be a losing one.*"[46] Although *First Nationwide Bank* is a RICO case, addressing "but-for" causation and "proximate cause," rather than the securities law concepts of transaction causation and loss causation, it articulates requirements similar to those of *Weiss* and *Manufacturers Hanover Trust.* A plaintiff must allege a material misstatement (*i.e.*, concealment of a risk), and that misstatement must be the cause of the plaintiff's loss (*i.e.*, the risk must materialize).

Thus, on closer examination, all three cases involve the concealment of a risk and the materialization of that risk. Unfortunately, however, the court in *Suez Equity* resolved the conflict in terminology by sticking with the term "investment quality." "Plaintiffs may allege . . . loss causation by averring [] that . . . the defendants' misrepresentations induced a disparity between the transaction price and the true *investment quality* of the securities at the time of the transaction."[47]

In *Emergent Capital,* decided only two years later, the court essentially conceded that the legal standard stated in *Suez Equity* was incomplete. "Plaintiff's allegation of a purchase-time value disparity, standing alone, cannot satisfy

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a twice-removed plaintiff's injuries. It does not articulate a standard of loss causation stricter than the Second Circuit's traditional standard.

[46] *First Nationwide Bank,* 27 F.3d at 769 (emphasis added).

[47] *Suez Equity,* 250 F.3d at 97-98 (quotation marks omitted).

the loss causation pleading requirement."[48] Rather, the *Emergent Capital* court noted that the *Suez Equity* plaintiffs "specifically asserted a causal connection between the concealed information — *i.e.*, the executive's [bad financial] history [and incompetence] — and the ultimate failure of the venture."[49] Thus, the *Emergent Capital* court applied the earlier standard of concealment of a risk and materialization of that risk without an explicit acknowledgment.[50]

Finally, in *Lentell*, the court paid lip service to *Suez Equity*[51] but held that the Second Circuit "require[s] both that

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[48] *Emergent Capital*, 343 F.3d at 198.

[49] *Id.*

[50] Indeed, even if *Emergent Capital* had explicitly reaffirmed the standard of *Suez Equity*, which calls only for a disparity between price and investment quality at the time of purchase — *i.e.*, artificial inflation — the standard would no longer be valid. In *Dura*, 125 S.Ct. at 1630, the Supreme Court overturned the Ninth Circuit's permissive standard for pleading loss causation, which required only that a plaintiff allege that a security's value was artificially inflated at the time of purchase.

[51] *See Lentell*, 396 F.3d at 174 ("We follow the holding[] of . . . *Suez Equity*."); *but see id.* at 173 ("We acknowledge that the pleading principles set out in the foregoing passage require both that the loss be foreseeable and that the loss be caused by the materialization of the concealed risk; and we further acknowledge that our opinion in *Suez Equity* can be mis-read to say that this Circuit has rejected the 'materialization of risk' approach. *Suez Equity* does not purport to express this Circuit's authoritative position, because that wording: (i) is dicta consigned to a footnote; (ii) is framed in terms that are tentative and speculative, *see [Suez Equity*, 250 F.3d] at 98 n. 1 ('The standard that we have employed

the loss be foreseeable *and* that the loss be caused by the materialization of the concealed risk."[52] It is thus beyond cavil that *Lentell* requires more than the bare "proximate cause" standard asserted by plaintiffs here.[53]

B. Application to *Liu v. CSFB*

It is vital to understand the nature of the risks that plaintiffs in the instant action allege were concealed. There are two kinds of risk. One risk is that the market could simply discover that the earnings estimates had been tainted by fraud, and that confidence in the securities would diminish, causing their prices to fall. The other risk is more central to plaintiffs' alleged scheme. Plaintiffs have alleged that defendants' scheme lowballed earnings estimates, warned the public that those estimates might be too low, and then reported earnings that exceeded those estimates. As a result, defendants induced the public to overvalue the securities. But when the investors eventually learned that the earnings did not always exceed expectations, their confidence collapsed, as did the price of the stock, causing their loss.

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in this opinion *attempts* to reconcile *what we view* as our *somewhat* inconsistent precedents on loss causation.') (emphasis added); and (iii) is expressly limited to what was (in 2001) 'our precedents *to date,' id.* (emphasis added).") (emphasis and parentheticals in original).

[52] *Id.* (beginning of second full paragraph; beginning of third full paragraph) (emphasis in original). Curiously, the exact same language, including the emphasis, appears twice on the same page of the *Lentell* decision.

[53] 2d Reconsideration Mem. at 3.

1. Disclosure of Falsity

The first type of "concealed risk" at issue here — *i.e.*, that the public might learn that the earnings estimates were fraudulent when made — *could* support a claim for securities fraud if plaintiffs had pled a disclosing event. *Lentell* teaches, however, that such a concealment can only cause losses after it is disclosed:

> plaintiffs have argued (affirmatively) on this appeal that the falsity of Merrill's recommendations was made public no earlier than April 2002, when the NYAG's affidavit "described the inner workings of Merrill's Internet Group," and that until then plaintiffs (and presumably the market at large) therefore lacked knowledge of the fraud. The complaints withstand the statute of limitations on the strength of that argument. By the same token, however, Merrill's concealed opinions regarding 24/7 Media and Interliant stock could not have caused a decrease in the value of those companies before the concealment was made public.[54]

The reasoning is simple. Where the alleged misstatement conceals a condition or event which then occurs and causes the plaintiff's loss, it is the materialization of the undisclosed condition or event that causes the loss.[55] By contrast, where the alleged misstatement is an intentionally false opinion, the

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[54] *Lentell*, 396 F.3d at 175 n.4.

[55] *See, e.g., Suez Equity* (concealed incompetence led to company's collapse); *Castellano*, 257 F.3d at 187 (concealed intent to recapitalize led plaintiff to sell stock in ignorance of the fact that company would recapitalize thereby vastly increasing stock value).

market will not respond to the truth until the falsity is revealed — *i.e.* a corrective disclosure.[56]

Plaintiffs have not alleged that defendants' fraudulent concealment of their true opinions was ever disclosed, and plaintiffs have made no attempt to tie such a disclosure to their alleged losses. Under *Lentell,* plaintiffs' failure to allege a corrective disclosure of the falsity of defendants' opinions precludes any claim that such falsity caused their losses.[57]

The circumstances of *Lentell* are strikingly similar to those alleged in the instant case. In both cases, plaintiffs argued that the fraud was not disclosed, if ever, until years *after* their losses were realized, in successful efforts to withstand dismissal based on the statute of limitations.[58] Both cases allege that plaintiffs' losses were caused when negative market events (*i.e.,* a downgrading of "buy" recommendations or a failure to meet earnings forecasts) were followed by a decline in securities prices. In *Lentell,* though, the court held that the fraudulent nature of the analysts'

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[56] *See Lentell,* 396 F.3d at 173 ("the misstatement or omission [involving favorable analyst recommendations] concealed something from the market that, when disclosed, negatively affected the value of the security."); *In re WorldCom, Inc. Sec. Litig.,* 2005 U.S. Dist. LEXIS 2216, 2005 WL 375314, at *6 ("A concealed fact cannot cause a decrease in the value of a stock before the concealment is made public.").

[57] *See id.* at 175 n.4.

[58] Specifically, the concealment in *Lentell* was alleged to have been disclosed when the New York Attorney General's office issued an affidavit describing the analysts' behavior. *See id.* In the instant case, no such disclosure has been alleged.

conduct was not revealed until "the inner workings of the [analyst] Group" were disclosed; the downgrading of "buy" recommendations did not disclose that the analysts' reports had been tainted.[59] In this case, the gulf between what was

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[59] *Id.* In *Lentell*, the "inner workings" of the analysts' group showed that the analysts ignored warnings that certain companies might fail. However, the analysts never lied about those specific defects; rather, their alleged fraud was to be unfailingly upbeat and to inflate share prices through repetitive positive reviews of the securities at issue. *See id.* at 165-66 (summarizing the alleged fraud, which involved "bullish research reports," publication of "BUY or ACCUMULATE" recommendations, and "profoundly unrealistic price targets," issued pursuant to agreements to pump up share prices and share in the investment banking proceeds). Thus, what the analysts concealed was that they did not believe in their own statements, and the effect of their false praise dissipated only when their alleged fraud came to light. *Compare id. with Fogarazzo v. Lehman Bros et al.*, No. 03 Civ. 5194 (Order of 2/10/05), in which I noted that plaintiffs had made the following allegations regarding concealment of specific investment risks:

> On September 7, 1999 . . . Lehman analysts resumed [Lehman's] 1-Buy rating and evaluated RSL's break-up value as exceeding $40 per share. Additionally, [an] analyst cited RSL's Delta 3 IPO as "pure upside to our valuation" of RSL. Documents reveal that RSL . . . in fact, thought little about Delta 3's long-term prospects.
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> . . .
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> Morgan Stanley . . . reiterated its Strong Buy rating and a $ 38.00 per share price target for RSL, even though . . . RSL announced [three days earlier] that it had taken a massive $32 million restructuring charge. Incredibly, in the same [] report, Morgan Stanley characterized the $32 million charge to earnings as "a positive for RSL."

2/10/05 Order in *Fogarazzo*, No. 03 Civ. 5194, at 3-4.

alleged to have been the concealed risk and the events that materialized is even more apparent: what was concealed was the analysts' belief that revenue *would* exceed forecasts, and what materialized was exactly the opposite. Accordingly, plaintiffs have *never* alleged any disclosure of the falsity of defendants' opinions.

2. The Market Conditioning Theory

With respect to the other allegedly concealed risk — that a complicated scheme misled the public as to the true value of the stock — the loss can only be caused when the true value of the securities is revealed to the public. This theory depends on the supposition that the investing public would disregard the available objective evidence of a company's performance (*e.g.*, its past verified earnings statements, its stature in the marketplace, and its posture in mergers and acquisitions) and instead overvalue the company by relying on the fraudulently nurtured belief that the company would continue to exceed earnings estimates indefinitely.

Lentell acknowledges that "systematically overly optimistic" analysts' reports (and, by analogy, the systematically pessimistic earnings forecasts alleged here), might sometimes support a claim of securities fraud.[60] However, "where [] substantial indicia of the risk that materialized are unambiguously apparent on the face of the disclosures alleged to conceal the very same risk," *Lentell* imposes a heavy burden on plaintiffs to plead their losses

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[60] *Lentell*, 396 F.3d at 177.

specifically.[61] As in *Lentell,* the hundreds of statements that accompanied defendants' earnings forecasts warned that defendants' estimates were unreliable and could be beaten.[62] In such cases, "a plaintiff must allege (i) facts sufficient to support an inference that it was defendant's fraud — rather than other salient factors — that proximately caused plaintiff's loss; or (ii) facts sufficient to apportion the losses between the disclosed and undisclosed portions of the risk that ultimately destroyed an investment."[63]

Plaintiffs have failed to allege facts sufficient to do either. Rather, they have alleged that the concealed risks materialized when one of three "Disclosing Events" occurred: (1) reported

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[61] *Id. Lentell* refers to the fact that the allegedly fraudulent analysts' recommendations in that case (*i.e.*, "buy" or "accumulate") were invariably accompanied by cautionary language that the stock prices were volatile. In fact, the securities at issue in *Lentell* were rated in the "most risky" possible category on a four-point scale. Plaintiffs in *Lentell* alleged that defendants' analyst reports concealed the risk of volatility in share prices — *i.e.*, the chance that the prices could plummet despite earlier "buy" recommendations. Thus, the "substantial indicia of the risk" were the warnings that the stock price was volatile, and they appeared "on the face" of the analyst reports. Put another way, *Lentell* establishes a standard for those situations in which allegedly misleading statements include cautionary language that the statements might be wrong or misleading. In such cases, plaintiffs must meet a heavy burden of alleging specific losses that are connected to the risks that were actually *concealed,* rather than those risks that were *disclosed* by defendants in their cautionary statements. *See id.*

[62] *See* Exs. D, E to Third Amended Complaint.

[63] *Lentell,* 396 F.3d at 177.

revenue failed to meet or exceed earnings forecasts; (2) a company announced such a shortfall before reporting revenues; or (3) analysts revised their estimates downward.[64] As I noted in my June 8, 2004 Opinion granting plaintiffs' motion for leave to amend their complaint, "each Disclosing Event was the unfortunate but commonplace event of a publicly traded company failing to meet its revenue forecast, coupled with a concomitant and predictable immediate drop in share prices."[65] Plaintiffs have made no effort to allege that it was the defendants' fraud that caused their losses. Nor have plaintiffs alleged "facts sufficient to apportion the losses" between that predictable immediate drop in share prices and any loss that might be attributable to investors abandoning their belief that earnings would exceed estimates forever.[66]

Accordingly, plaintiffs have failed to allege loss causation.

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[64] Third Amended Complaint ¶ 225.

[65] *In re IPO ("Liu I")*, 341 F. Supp. 2d 328, 350 (S.D.N.Y. 2004).

[66] *Lentell*, 396 F.3d at 177.

V. CONCLUSION

For the foregoing reasons, plaintiffs' second motion for reconsideration is denied in its entirety. The Clerk is directed to close this motion and this case.

SO ORDERED:

/s/_____
Shira A. Scheindlin
U.S.D.J.

Dated: New York, New York
June 27, 2005